Tax Hotline

June 15, 2021

CBDT PRESCRIBES VALUATION RULES FOR SLUMP SALES: PLUGGING THE GAP

- CBDT prescribes rules for determining the 'full value of consideration' in case of slump sales, for computing capital gains.
- The rules provide that the higher of the value determined basis a book-value formula (FMV1) or the actual consideration (FMV2) shall be considered to be the full value of consideration.

Recently the Central Board of Direct Taxes ("**CBDT**") released the much-awaited valuation rules for computing capital gains arising from a slump sale ("**Valuation Rules**"). The Valuation Rules come on the heels of an amendment made earlier this year via the Finance Act, 2021 requiring capital gains from slump sales to be computed with reference to fair market value ("**FMV**") of the undertaking being transferred.

A slump sale has been defined as the transfer of one or more undertakings for a lump sum consideration without assigning values to individual assets. By way of a deeming fiction under the provisions of the Income Tax Act 1961 ("**ITA**"), profits and gains arising from a slump sale are chargeable to tax as capital gains.[1]

For purposes of computing capital gains from a slump sale, the net worth of the undertaking is deemed to be the cost of acquisition.[2] Prior to the Finance Act, 2021, there was no stipulation regarding the determination of the full value of consideration for computing capital gains in case of slump sales. However, the Finance Act 2021 brought about an amendment in this regard which provides that the full value of consideration shall be deemed to be the FMV of the undertaking to be determined as per prescribed rules ("**Amendment**"). The rules for determining this FMV is what has been prescribed by the Valuation Rules.

The Valuation Rules provide two methods for determining the FMV and the higher of the two shall be considered to be the FMV. The two methods are:

1. **Book-value based formula** ("**FMV1**"): Broadly under this method, the value is a function of the book value of all the assets (other than jewellery, artistic work, shares, securities and immovable property ("**Excluded Assets**")) as reduced by the book value of all the liabilities.

   The value of the Excluded Assets are to be determined in the following manner:

   - *Jewellery and artistic work:* the price they would fetch if sold in the open market on the basis of a valuation report obtained from a registered valuer,
   - *Shares and securities:* the fair market value of shares and securities as determined per the formulae (akin to book value) prescribed under Rule 11UA(c)(b) of the Income Tax Rules, 1962 ("**Rules**"),
   - *Immovable property:* the value adopted or assessed by any authority of the Government for the purpose of payment of stamp duty in respect of the immovable property.

   Further, the following shall be excluded from computing the book value of the liabilities: (a) the paid up capital in respect of equity shares, (b) the amount set apart for payment of dividends on preference shares and equity shares at a general body meeting where such dividends have not been declared before the date of transfer, (c) reserves and surplus other than those set apart towards depreciation, (d) amounts representing provisions for taxation, (e) amounts representing provisions for meeting liabilities other than ascertained liabilities, and (f) amounts representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares ("**Excluded Liabilities**").

2. **Actual consideration received ("FMV 2"):** this should be a sum of the monetary and non-monetary consideration received or accrued as a result of the slump sale. The non-monetary consideration shall be computed in the following manner: (a) *property referred to in Rule 11UA(1) (i.e. jewellery, artistic work, shares and securities):* valuation method prescribed for such property in Rule 11UA; (b) *property (other than immovable property) not referred to in Rule 11UA(1):* the price it would fetch in the open market on the basis of a valuation report obtained from a registered valuer; (c) *immovable property*: the value adopted or assessed by any authority of the Government for the purpose of payment of stamp duty in respect of the immovable property.

The Valuation Rules provide that the value for computing capital gains in case of slump sales shall be determined as on the date of the slump sale.

ANALYSIS

In case of transfer of shares and immovable property, the computation provisions under the ITA provide that if the full value of consideration is less than the FMV, then the FMV shall be deemed to be the full value of consideration for the purposes of computing capital gains.[3] However, no such provision existed in respect of business transfers by way of slump sales. As such, there were no restrictions on the price at which slump sales could be carried out from a tax computation perspective. This made slump sales a very attractive tool for domestic M&A and restructurings, and for the India leg of multi-jurisdictional M&A.

The Amendment read with the Valuation Rules, by providing that the higher of the actual consideration or the FMV (determined in the prescribed manner) shall be deemed to be the full value of consideration for computing capital gains in slump sales, seek to align the rules pertaining to valuation for transfer of shares and immovable property with that of business transfers by way of slump sales, plugging the gap on the tax arbitrage opportunity that slump sales provided.

As a result, businesses will now be guided by a certain sense of pricing in respect of slump sales, at least insofar as ascertaining the tax implications are concerned. In multi-jurisdictional M&A involving an India-level slump sale, the Valuation Rules will also need to be factored in while undertaking purchase price allocation to Indian assets.

Further, even in terms of valuation of specific assets for FMV1, the attempt has been to align the rules with those for valuation of property for the purposes of transfer of shares and immovable property.

Even though there were no pricing restrictions until now, most slump sales were being carried out at book value. As is evident, the formula for FMV1 is akin to book value except that fair valuation is required to be done for shares and immovable property owned by the undertaking being transferred. Hence, in case of transfer of undertakings that do not contain immovable property / shares, not much has changed in respect of the valuation methodology for slump sales. Further, if the conservative view in respect of applicability of section 56 to slump sales were to be considered, then even with respect to undertakings containing shares and immovable property, not much has changed because of the Valuation Rules since section 56 anyway requires a book value computation similar to the Valuation Rules.

An added complexity arises in case of intra-group restructuring exercises involving slump sales. Such intra-group slump sales may in certain cases be subject to transfer pricing regulations where they are ‘deemed international transactions’ under Section 92B(2) of the ITA. In such cases, a question arises as to whether valuation as per the arm’s length standard under the transfer pricing regulations will need to be undertaken for an intra-group slump sale, or whether the Valuation Rules would apply.

CONCLUSION

Having said the above, the key feature of a slump sale, which is the primary reason for its attractiveness, i.e. the cost of acquisition is deemed to be the ‘net worth’ of the undertaking still remains. This allows the taxpayer to disregard the cost of acquisition and holding periods of each underlying asset. It permits a claim of the concessional tax rate on long term capital gains to an undertaking that as a whole has been held for three years or longer, regardless of how long the underlying assets may have been held. Owing to this feature, despite the Valuation Rules and the complexities arising therefrom, slump sales are likely to continue to be opted for as a preferred mode for business transfers in India.

– Varsha Bhattacharya & Afaan Arshad
You can direct your queries or comments to the authors

---

[1] Section 50B (1), Income Tax Act, 1961
[2] Section 50B(2)(i), Income Tax, 1961
[3] Sections 50C and 50CA, ITA

Vaibhav Parikh, Partner, Nishith Desai Associate on Tech, M&A, and Ease of Doing Business
March 19, 2025

SIAC 2025 Rules: Key changes & Implications
February 18, 2025